

A Brief Look at the Distribution of Kentucky Taxes

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Concepts of Equity: Vertical Equity

- From the MIT Dictionary of Modern Economics:
- Vertical Equity. “Justice or fairness in the treatment of individuals in different circumstances. In the field of taxation, vertical equity is held to require that individuals’ tax burdens should be related to income levels.”



Concepts of Equity: Horizontal Equity

- Horizontal Equity. “Fairness or justice in the treatment of individuals in similar circumstances. The concept is most frequently used with regard to tax and income, thus horizontal equity may be said to be attained if individuals with the same income face the same tax burden.”



Examples of Horizontal Inequity?

- From the Individual Income tax:
 - The “Marriage Tax”: Married (filing jointly) & unmarried, cohabitating couples (filing separately) have different tax burdens
 - Tax treatment of different sources & forms of income and compensation:
 - Labor vs. Capital Income
 - Pension, Transfers
 - Fringe Benefits
 - Renting vs. Owning



Examples of Horizontal Inequity (2)?

- From Other Taxes:
- General Sales Tax
 - Tangibles (taxed) vs. Services (untaxed)
 - Food at Home (untaxed) vs. Restaurant (taxed)
- Selective Sales Tax
 - Alcohol
 - Tobacco



Broad-Based Taxation and Horizontal Equity

- Most economic literature evaluating the breadth of a tax base or “flat” income taxes has focused on implications for efficiency
- Implications for horizontal equity as well:
 - broader sales tax base (more goods & services taxed) should reduce variation in taxes for individuals with similar incomes
 - Reductions in deductions in individual income tax



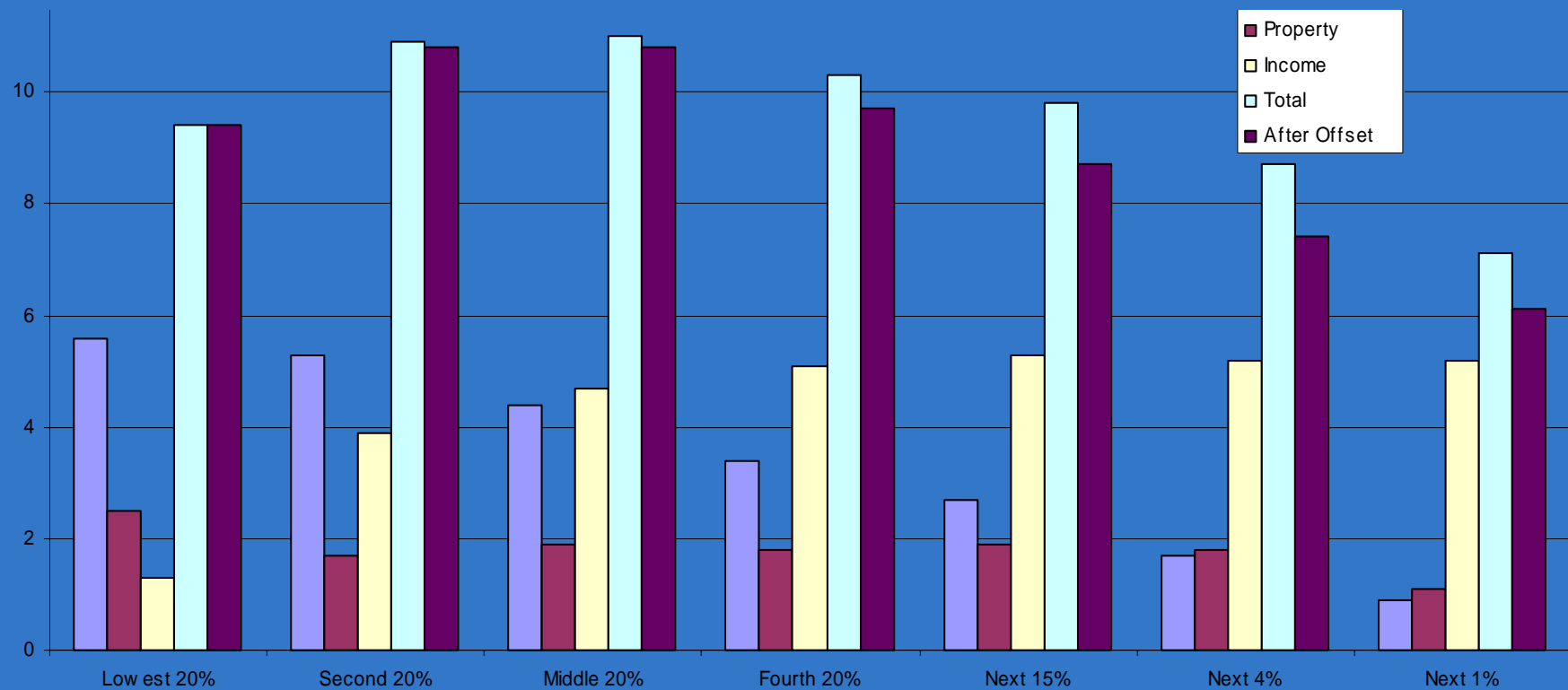
The Distribution of Taxes

- To determine the burden of taxes it is necessary to determine the incidence
- Who actually pays? Economic vs. Legal Incidence
- Consensus among economists:
 - Consumer bears burden of sales taxes
 - Employees bears burden of payroll taxes

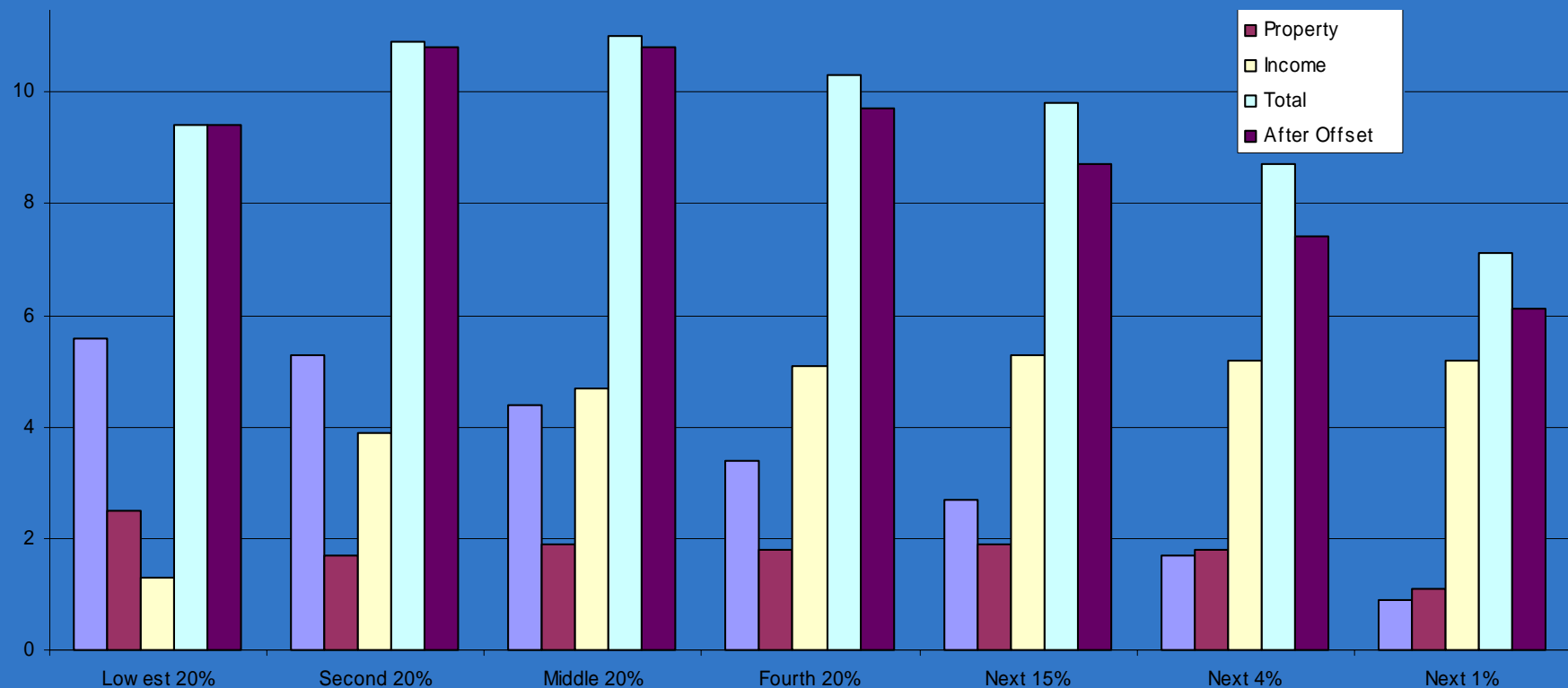


Tax Shares of Income by Income Level

Kentucky, 2007

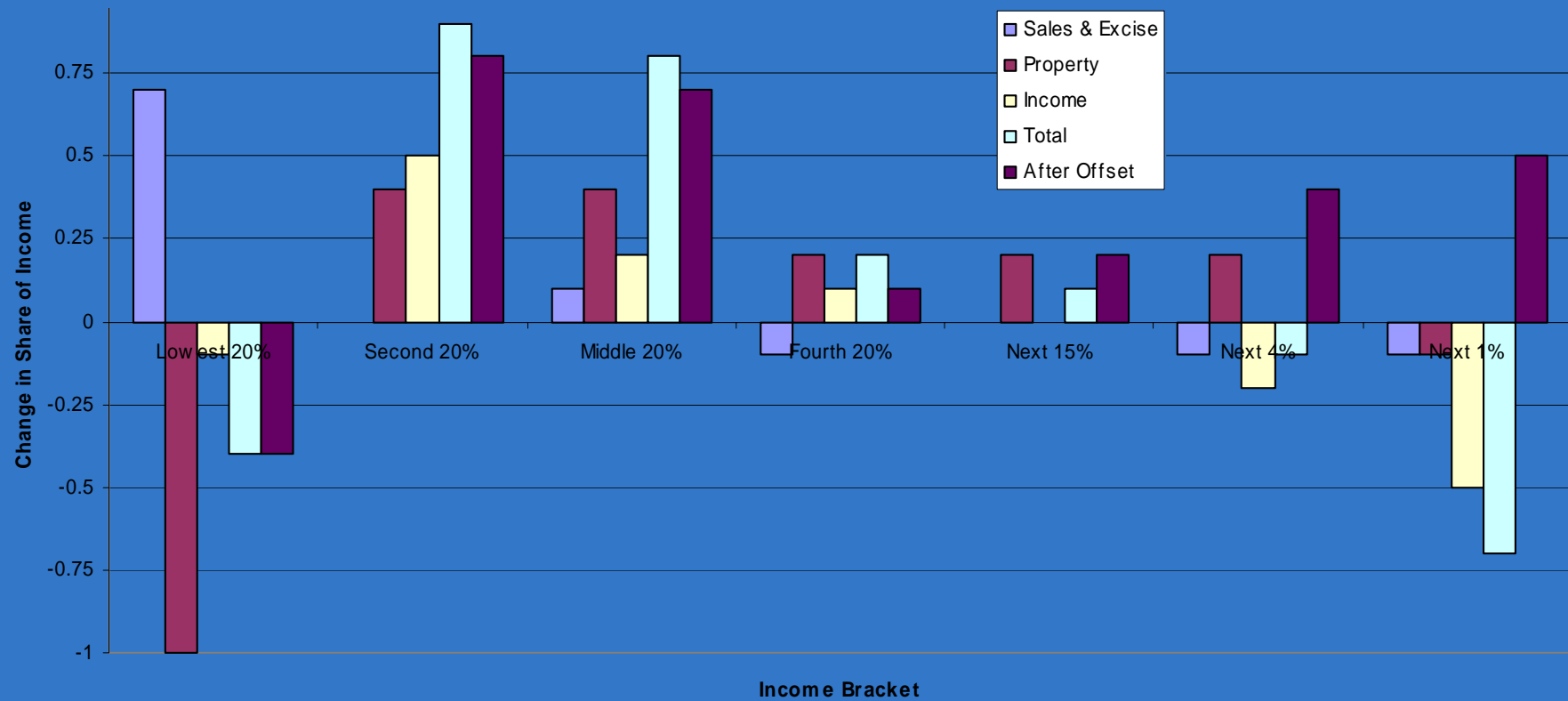


Tax Shares of Income by Income Level Kentucky, 2007

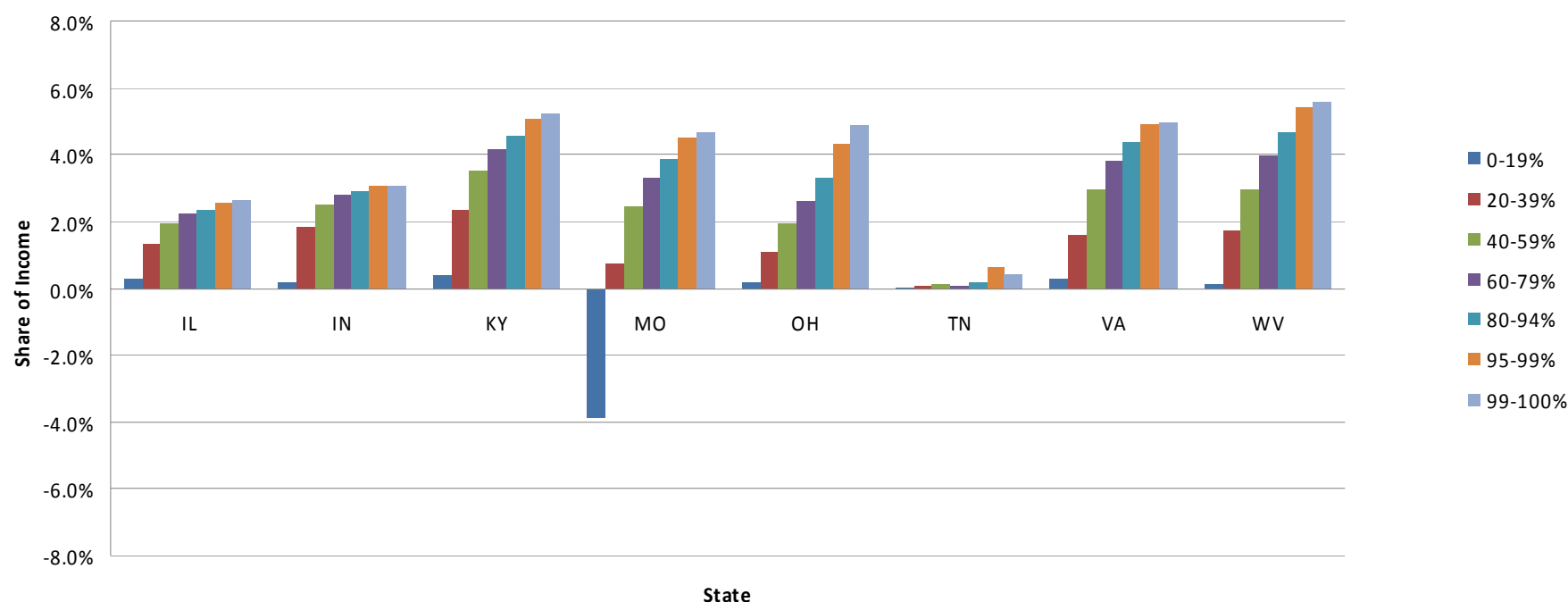


Based on: Davis, Carl et. al *Who Pays? A Distribution Analysis of the Tax Systems in All 50 States*, Institute on Taxation and Economic Policy, Washington, DC, November 2009.

Change in Tax Shares of Income by Income Level, Kentucky 2002-2007

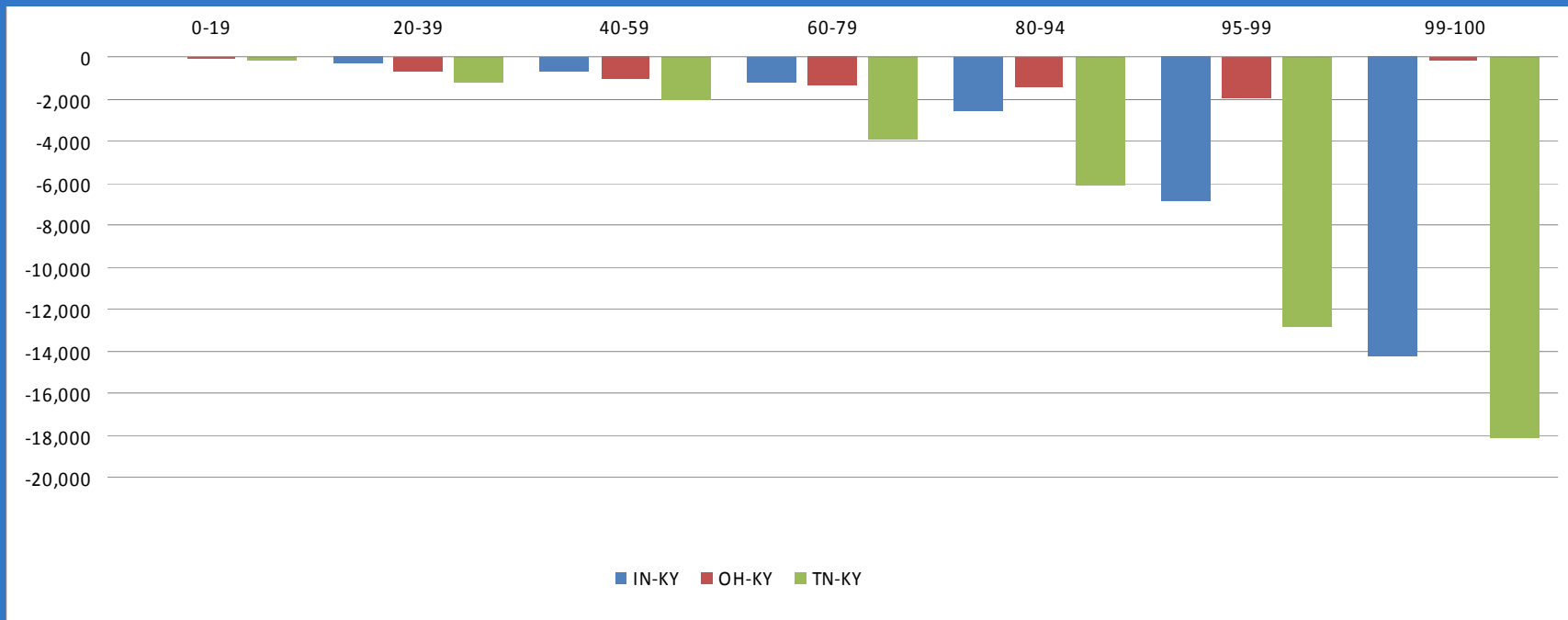


Individual Income Tax Share (2008) for KY Residents in Other States



Calculations using data from the Integrated Public Use Microdata Series (IPUMS) from the University of Minnesota (<http://www.ipums.umn.edu/>) and the National Bureau of Economic Research (NBER) TaxSim program.

Difference in Income Tax Burdens, Kentucky vs. Indiana, Ohio, Tennessee (2008)

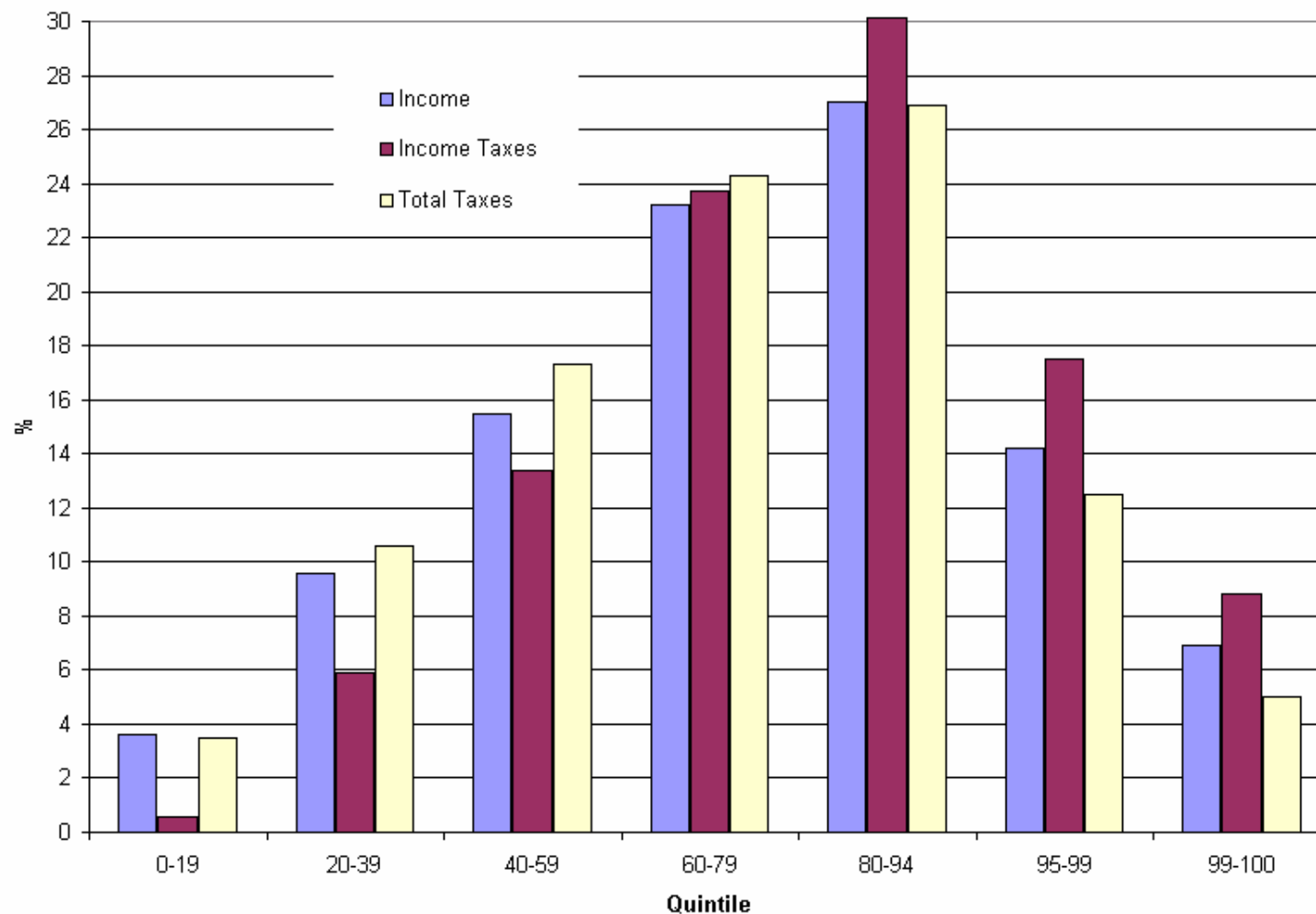


Limits to Redistribution

Quintile	0-19	20-39	40-59	60-79	80-94	95-99	99-100
Income (% of Total)	3.6	9.6	15.5	23.2	27.0	14.2	6.9
Income Taxes (% of Total)	0.6	5.9	13.4	23.7	30.1	17.5	8.8
Total Taxes (% of Total)	3.5	10.6	17.3	24.3	26.9	12.5	5.0
Average Income	10,911	28,747	47,050	70,103	108,907	213,189	424,564
Income Tax (per household)	74	728	1,681	2,960	5,022	10,886	22,482
Total Taxes (per household)	1,026	3,133	5,176	7,221	10,673	18,547	30,144
Income Tax Rate	0.68	2.53	3.57	4.22	4.61	5.11	5.30
Total Tax Rate	9.4	10.9	11	10.3	9.8	8.7	7.1

Limits to Redistribution (2)

Share of Income and Income and Total Tax Revenue, by Income Distribution



Limits to Redistribution (3)

- Consider a decrease in tax rate of 0.5% for the households with income in the lowest 40% of distribution financed by an increase in taxes on the highest 5% of distribution
- Decrease in their payments of \$71 on average
- Increase in rate of .31% for highest 5%
- Average increase of \$667 for those in the 95 – 99% & \$1,328 for the top 1%
- Question: How does this affect the mobility of households?

Annual vs. Lifetime Incidence

- Some Economists have argued that the focusing on current income when considering tax incidence is misleading.
- Instead:
 - Consider taxes on a lifetime basis
 - Consider consumption not income
- With these considerations Metcalf (1991) suggests:
 - State general sales and state and local property taxes are mildly progressive
 - Income taxes are less progressive than on annual basis



A Few Closing Thoughts

- Significant differences in the tax instruments used by Kentucky and its neighbors, the level of state and local own-source revenue are quite similar
- Kentucky is one of the lowest taxed states on a per capita basis.
- When based as a share of income, Kentucky's taxes are higher.
 - This is primarily due to the fact that incomes are lower in Kentucky than all its neighbors except West Virginia.



A Few Closing Thoughts (2)

- Low incomes and the centralized nature of revenue collection in Kentucky explains the high individual income tax rates.
- Tax burdens imposed by the individual income tax rate in Kentucky are generally higher than those in the states it shares the largest borders with – Indiana, Ohio, and Tennessee.

